Filed 6/4/03 Downey v. Hartford Fire Ins. CA6

NOT TO BE PUBLISHED IN OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SIXTH APPELLATE DISTRICT

JAMES B. DOWNEY,

Plaintiff and Appellant,

v.

HARTFORD FIRE INSURANCE CO.,

Defendant and Respondent.
_____/

H024186
(Santa Clara County
Super. Ct. No. CV783448)

In this appeal plaintiff James Downey seeks review of a summary judgment entered in favor of defendant Hartford Fire Insurance Company on his claims of breach of contract, breach of the covenant of good faith and fair dealing, and fraud.[1] Downey contends that these claims were viable notwithstanding Civil Code section 2860, subdivision (c),[2] which provides for arbitration of disputes over the fees charged by independent counsel for defending an insured. We conclude that summary judgment was the appropriate disposition in these procedural circumstances and therefore affirm the judgment.

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1 Downey appealed "from the court's ruling on August 29, 2001," which was the order granting summary judgment. Such orders are not appealable. However, we will construe the notice of appeal to have been from the judgment entered on January 3, 2002.

2 All further statutory references are to the Civil Code unless otherwise specified.

Background

Plaintiff Downey was an officer and director of Cartesian Data, Inc. (CDI), which was insured under a commercial general liability policy by defendant Hartford Insurance Company ("Hartford"). In March 1996 a former CDI employee sued CDI, Downey, and two other CDI officers for sex discrimination, sexual harassment, wrongful termination, and other acts arising out of her employment with and discharge from CDI. Hartford accepted the defense of CDI subject to a reservation of rights. Hartford believed that only one of the 11 causes of action triggered its duty to defend while the others were not potentially covered. CDI's counsel, Mark Parnes of Wilson, Sonsini, Goodrich & Rosati, informed Hartford that the individual defendants, including Downey, had obtained separate counsel "to avoid any potential conflict of interest," though the firm was unaware of any such conflict at that time. Parnes believed that all of the individual defendants were insureds.

Downey retained Littler, Mendelson, Fastiff, Tichy & Mathiason (Littler, Mendelson) in May 1996, but on September 16, 1996, he replaced that firm with Tim Davis of Clapp, Moroney, Bellagamba, Davis and Vucinich (Clapp, Moroney). Meanwhile, Downey tendered the action to his carriers under his homeowner's and personal umbrella policies, which had been issued by subsidiaries of Farmers Insurance (Farmers). Farmers agreed to provide Downey with a defense, but on September 9, 1996, it withdrew its defense because there was no coverage under its policies.

In December 1996 Hartford agreed to defend Downey under a reservation of rights.[3] During the year that followed Hartford paid Clapp, Moroney's bills for representing Downey. In April 1998, however, Hartford began to question some of the charges billed for the first quarter of 1998. The Hartford claims handler, Barbara Nemec,

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3 Hartford did not learn of the tender to Farmers or its outcome until discovery had begun in the present action.

had noticed that some of the entries on the invoice pertained to bankruptcy issues, and she questioned the relevance of this work to a sexual harassment and wrongful termination action. Nemec was also concerned that various defense attorneys were billing materially different amounts for attending the same depositions and that some of the defense attorneys were submitting invoices that had already been paid. Hartford began withholding payment of the bills received for work performed during 1998.

In May 1998, the parties in the underlying action settled the case for $50,000, which Hartford paid. Clapp, Moroney submitted its final bill on September 1, 1998, bringing the total of its unpaid bills to $32,465.

To resolve her concerns over the bills submitted by independent counsel, Nemec sent the invoices to Hartford's legal fee auditing division, the Confluence Group (Confluence). Confluence notified independent counsel for each defendant that the audit would take place on September 14, 1998, and it asked each attorney to bring along all litigation file materials for its review.

Davis objected to the request to turn over all the confidential files related to his defense of Downey. The attorneys for the other individual defendants also resisted. Davis expressed concern that Hartford might use this information in a subsequent effort to obtain reimbursement of defense fees and costs in breach of its agreement with the defendants. He suggested that an audit might be possible if Hartford promised in writing not to seek reimbursement of those fees and costs. Citing section 2860, Hartford declined to waive its right to "review fees and costs for reasonableness." Davis protested that this statute did not permit a review of litigation files, which typically included "many attorney/client and attorney work product documents and information." Davis offered Nemec the opportunity to come to his office personally and review his files, since she was familiar with the case. She did not do so, however. Clapp, Moroney was not compensated for the work it performed between January 16, 1998 and September 1998.

On July 23, 1999, Downey filed the instant action against Hartford, alleging breach of contract, breach of the covenant of good faith and fair dealing, and fraud. On October 7, 1999, Hartford petitioned to compel arbitration of the entire action under section 2860, subdivision (c). Alternatively, it sought arbitration of some issues with a stay of the action on the nonarbitrable ones. On January 20, 2000 the court granted the petition to compel arbitration "with respect to the attorney's fees claimed in this action" but denied without prejudice the request to stay the remainder of the action.

Subsequently the court overruled a demurrer by Hartford, denied the request for a stay, and denied Hartford's motion to strike portions of Downey's complaint. Hartford then filed an answer to the complaint and a cross-complaint, seeking a declaration that it owed Downey no fees or costs because he and/or his attorney had breached their obligations under section 2860, under the policy, and under the implied covenant of good faith and fair dealing. Hartford also claimed that it had owed no duty to defend Downey or to pay any of his independent counsel fees or costs, because there was no conflict of interest between him and CDI.

On July 30, 2001, Hartford moved for summary judgment or, alternatively, summary adjudication. Hartford argued that the parties' dispute over attorney fees could not serve as the basis of a breach of contract claim but was confined to the remedy provided in section 2860, subdivision (c). Hartford also asserted that it was undisputed that Downey had refused to cooperate with Hartford's audit request, contrary to section 2860, subdivision (d), and the cooperation clause of CDI's insurance policy. As to the second cause of action, Hartford contended that Downey could not establish bad faith because there were "legitimate reasons" for the audit and a resulting "genuine dispute" regarding the fees. The fraud claim, in Hartford's view, was without merit because Downey had not relied on any of the alleged misrepresentations or suffered resulting damage. Finally, Hartford challenged Downey's claim for punitive damages and damages for emotional distress.

The trial court agreed with Hartford, ruling as follows: "Defendant met its burden of showing that Plaintiff cannot establish that it breached the subject insurance policy. Defendant satisfied its duty to indemnify Plaintiff by settling the underlying action and paying the $50,000 settlement. . . . Further, Defendant satisfied its duty to defend by furnishing competent independent counsel subject to a reservation of rights. . . . Defendant paid for the independent counsel's legal fees during the course of the underlying action. . . . Since the instant fee dispute arose after settlement had been reached and did not affect the quality of the independent counsel's advice, it cannot constitute a breach of Defendant's duty to defend. . . . Further, to the extent there is a dispute over the rate and scope of legal fees to be paid to independent counsel for defense of the underlying action, it [is] subject to binding fee arbitration pursuant to Civil Code §2860(c). . . . Plaintiff failed to raise a triable issue of material fact regarding any of these issues."

Downey then filed a petition to compel appointment of a neutral arbitrator to resolve the attorney fees issue. He stated that he had made numerous unsuccessful attempts to obtain cooperation from Hartford in selecting an arbitrator to comply with the court's January 20, 2000 order granting Hartford's petition to compel arbitration. On October 18, 2001, the trial court denied his petition to appoint an arbitrator.[4] Thereafter

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4 The court did not explain this ruling. Hartford had opposed the motion on several grounds, including that Downey had not paid any of the claimed fees, that none of the attorneys involved had sued Downey, and that it was too late for these attorneys to seek recovery of the fees from Downey.

The court also denied a motion by Downey for summary judgment on Hartford's cross complaint, finding that Downey had failed to show "an actual conflict of interest between he [*sic*] and the other defendants in the underlying action, that there was a contract precluding Cross-complainant Hartford from seeking reimbursement, that Hartford waived its right to reimbursement, that Hartford is estopped from claiming reimbursement, or that Hartford's claims are barred by the applicable statute of limitations."

the parties stipulated to dismissal of the cross-complaint with entry of judgment for Hartford on Downey's complaint.

Discussion

1. Standard and Scope of Review

Because Downey challenges only the order granting summary judgment to Hartford, our review is governed by settled principles governing summary judgment procedure. Summary judgment is proper when there is no triable issue of material fact and the moving party is entitled to judgment as a matter of law. (Code Civ. Proc., § 437c, subd. (c).) In reviewing an order granting summary judgment, we exercise our independent judgment, applying the same analysis as the trial court. (*Aguilar v. Atlantic Richfield Co*. (2001) 25 Cal.4th 826, 860.)

A defendant making the motion has the initial burden of showing that one or more elements of each cause of action cannot be established or that there is a complete defense to the action. (Code Civ. Proc., § 437c, subd. (o); *Aguilar v. Atlantic Richfield Co., supra,* 25 Cal.4th at pp. 853-854.) The defendant can meet this burden by affirmatively showing that "the plaintiff does not possess, and cannot reasonably obtain, needed evidence" (*Id.* at p. 854.) If the defendant fails to meet this initial burden, it is unnecessary to examine the plaintiff's opposing evidence; the motion must be denied. (*Scheiding v. Dinwiddie Construction Co.* (1999) 69 Cal.App.4th 64, 71-72; accord, *Saelzler v. Advanced Group 400* (2001) 25 Cal.4th 763, 768.) However, if the moving party makes a prima facie showing that justifies a judgment in the defendant's favor, the burden then shifts to the plaintiff to make a prima facie showing that there exists a triable material issue of fact. (*Aguilar v. Atlantic Richfield Co.*, *supra*, 25 Cal.4th at p. 850.) In meeting this obligation, the plaintiff may not rely on the mere allegations of its pleadings, but must "set forth the specific facts showing that a triable issue of material fact exists as to that cause of action . . . ." (Code Civ. Proc., § 437c, subd. (p)(2); *Merrill v. Navegar, Inc.* (2001) 26 Cal.4th 465, 476-477.)

Because it is the pleadings that define the issues addressed in a summary judgment proceeding, we first examine the allegations of Downey's complaint. The claim for breach of contract was based on the allegation that Hartford had "reneg[ed]" on its promise to pay the 1998 Clapp, Moroney fees and waive any right to reimbursement. The cause of action for breach of the covenant of good faith and fair dealing is premised on the allegation that Hartford had deprived Downey of "the contractual and statutory benefits due to him pursuant to the policy." In the fraud claim Downey alleged that both John Hughes, Hartford's coverage counsel, and Nemec had falsely represented to him that Hartford would pay Downey's outstanding legal fees and not seek reimbursement.

2. Breach of Contract and the Covenant of Good Faith and Fair Dealing

In support of the summary judgment motion Hartford offered 497 assertedly undisputed facts. Downey acknowledged that Hartford had agreed to reimburse his independent counsel subject to its reservation of the right to seek reimbursement for defense costs, attorney fees, and any settlement amounts pertaining to non-covered claims. Downey further accepted as undisputed that Hartford had not yet sought reimbursement for the $50,000 settlement, but he did dispute, citing the cross-complaint, Hartford's assertion that it had not sought reimbursement for the attorney fees it had paid. Downey also disputed Hartford's statement that it had never agreed in writing not to seek reimbursement of defense fees.[5]

The gravamen of Downey's complaint is that Hartford had "failed to pay all sums reasonably incurred for Downey's defense." Though he alleged a breach of the

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5 Downey did not offer any evidence that supported his challenge, however. He cited "multiple oral conversations" between him and Nemec; a letter his attorney, Davis, had written to Hartford; the settlement check Hartford had written to Davis; and a letter from Nemec. Nemec's letter, however, stated that Hartford "has waives [*sic*] its rights for reimbursement in regards [*sic*] to the coverage issues, but . . . will not waive its rights under . . . section 2860 to review fees and costs for reasonableness."

"insurance agreement," Downey has not cited any specific policy provision that was breached, but instead has asserted entitlement to reimbursement based on a general "policy benefit" inherent in the policy. The only specific promises he refers to are the alleged assurances by Nemec before and after the settlement that it would waive its right to reimbursement.[6] Downey also urges this court to view Hartford's conduct as a breach of the duty to defend.

It is not necessary to determine how Hartford's failure to pay should be characterized. Whether Hartford's failure to reimburse Downey for the defense is viewed as a breach of a specific contractual promise to pay, an implied policy benefit, or the broader duty to defend, the scope of Hartford's obligation to pay was a question that was controlled by section 2860.

Section 2860 describes a mechanism for insured defendants to obtain independent counsel and be reimbursed for counsel's fees in the event of a conflict of interest. Subdivision (a) states: "If the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent counsel to the insured, the insurer shall provide independent counsel to represent the insured unless, at the time the insured is informed that a possible conflict may arise or does exist, the insured expressly waives, in writing, the right to independent counsel. An insurance contract may contain a provision which sets forth the method of selecting that counsel consistent with this section."

Subdivision (c) of section 2860 states, in pertinent part: ". . . . The insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim

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6 Downey also alleged a breach of contract by failing to respond in a timely way to his tender of the defense, but this issue is not renewed on appeal.

arose or is being defended. This subdivision does not invalidate other different or additional policy provisions pertaining to attorney's fees or providing for methods of settlement of disputes concerning those fees. *Any dispute concerning attorney's fees not resolved by these methods shall be resolved by final and binding arbitration by a single neutral arbitrator selected by the parties to the dispute.*" (Italics added.) Thus, where, as here, the parties have agreed that "independent counsel is warranted and where independent counsel is actually retained, subdivision (c) provides a simple remedy for resolving disputes concerning the fees to be paid to that individual or firm: arbitration." (*Truck Ins. Exchange v. Dynamic Concepts, Inc.* (1992) 9 Cal.App.4th 1147, 1150.)

The trial court correctly viewed this case as a legitimate dispute "over the rate and scope of legal fees to be paid to independent counsel for defense of the underlying action." Downey claimed the right to reimbursement for all of the defense fees he incurred, while Hartford questioned a number of billing entries. We agree with the lower court that this controversy was subject to arbitration rather than adjudication by trial. Characterizing Hartford's conduct as a breach of the duty to defend does not alter the essential nature of the dispute or remove it from the reach of section 2860.

Downey maintains that triable issues of fact exist on his contract claim. His argument, however, turns upon the following premise: "Since the entitlement to [independent counsel] fees is a policy benefit, assuming that any such fees are actually still owed, Hartford is in breach of contract." Downey jumps ahead in his analysis. Whether "such fees are actually still owed" is the question that is directed to the arbitrator, not the factfinder at trial. Until fees are found by arbitration to be owing, even under Downey's logic, the question of breach is premature.

As to the alleged promise to waive any right to reimbursement, Hartford presented affirmative evidence that Hartford continued to reserve its right to seek reimbursement of defense fees and costs. Downey offered no evidence raising a triable issue regarding this fact. His opposition to summary judgment referred to Hartford's assurances, primarily

through Nemec, that it would pay Davis's 1998 bills. Whether Nemec was expressing expectation or intent, these alleged statements, which contradicted Hartford's express reservation of rights, did not in themselves constitute a contract.[7]

Downey's cause of action for breach of the covenant of good faith and fair dealing also was subject to summary adjudication. "[T]he covenant is implied as a supplement to the express contractual covenants, to prevent a contracting party from engaging in conduct that frustrates the other party's rights to the benefits of the agreement. [Citation.] Thus . . . when benefits are due an insured, 'delayed payment based on inadequate or tardy investigations, oppressive conduct by claims adjusters seeking to reduce the amounts legitimately payable and numerous other tactics may breach the implied covenant because' they frustrate the insured's right to receive the benefits of the contract in 'prompt compensation for losses.' [Citation.] Absent that contractual right, however, the implied covenant has nothing upon which to act as a supplement, and 'should not be endowed with an existence independent of its contractual underpinnings.' " (*Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 36.) Here Downey failed to establish a breach of a policy provision. Had it been established through arbitration that the fees claimed by Downey were reasonable, he might have had a cause of action for breach of the covenant of good faith and fair dealing. Until that determination was made, however,

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7 Because section 2860 governs this dispute, it is unnecessary to discuss Hartford's contention that it is "undisputed that Downey refused to cooperate with Hartford's audit request." This statement is incorrect, as Downey's cooperation certainly was a fact in dispute. Nor need we address Hartford's assertion that there was "undisputed evidence" that Hartford had no obligation to pay defense costs; this was a conclusion of law that was based on other legal conclusions, not entirely on undisputed facts. Similarly, whether there was a true conflict of interest required resolution of disputed facts and therefore was not an issue for summary adjudication. Nevertheless, none of these factual and legal questions was material to the central issue, the applicability of section 2860.

this was in essence a dispute over the reasonableness of fees Hartford owed, which was not appropriate for resolution by trial.

Hightower v. Farmers Ins. Exchange (1995) 38 Cal.App.4th 853, cited by Downey, is distinguishable on this point. In *Hightower*, the insurer's liability was clear. In that circumstance, the insurer was not permitted to avoid bad faith liability by demanding arbitration after it stonewalled an uninsured motorist claimant and delayed payment of benefits. Here, the foundation of the bad faith claim—the amount of defense fees to be reimbursed-- remained disputed and had not yet been sent to arbitration when Downey filed this action. The court thus appropriately recognized that the fees issue must be resolved by arbitration before allowing the issue of bad faith to be tried.

3. Fraud Cause of Action

Downey's third cause of action was essentially a claim of promissory fraud, which comprises the elements of misrepresentation, knowledge of its falsity, intent to defraud (i.e., to induce reliance), justifiable reliance, and resulting damage. (See, e.g., *Engalla v. Permanente Medical Group* (1997) 15 Cal.4th 951, 973-974.) Downey's claim was based on the allegedly false representations of Nemec and Hughes that it would pay Downey's outstanding legal fees. He listed several dates on which Hartford had allegedly promised it would not seek reimbursement of defense fees and costs. Downey asserted that he had relied on these representations "by agreeing to the settlement, by continuing to employee [*sic*] attorneys that Hartford had indicated it would pay in full, and by permitting his attorneys to finalize a settlement that substantially reduced Hartford's potential liability." In their separate statements of undisputed facts, however, the parties agreed that all of Littler, Mendelson's unpaid fees and most of Clapp, Moroney's unpaid fees had been incurred before the first of these alleged representations.

Downey does not renew his opposition to summary adjudication of the fraud cause of action except in his reply brief, in response to Hartford's argument. He repeats the allegations of the complaint, citing as evidence of reliance certain paragraphs in the

declarations of Downey and Davis. In the first cited paragraph of Downey's declaration he stated, "At the time of the settlement of the [underlying] litigation, I was told by my attorney that there was an agreement that Hartford would not seek reimbursement of any funds it had paid for attorney fees and that it would be paying all the remaining attorney fees. I would have never authorized my attorney Tim Davis of Clapp Moroney to take such an active, time consuming role in the case if I would have [*sic*] known that Hartford was intent on denying payment for Clapp Moroney['s] legal services." Davis similarly stated in his declaration that "[i]f I would have [*sic*] known that Hartford was not going to pay my bill I would have never continued in my representation and would have sought to substitute out." Finally, Downey cites the statement in his declaration that by settling with the plaintiff in the action against him, he undertook a "significant sacrifice" because he gave up the opportunity to sue her for malicious prosecution or slander.

Neither of the proffered declarations shows how his entitlement to reimbursement was altered in any way by settling the case. At all times Hartford had the right to settle the case and to question the reasonableness of the fees charged by independent counsel.[8] (Cf. *Western Polymer Technology, Inc. v. Reliance Ins.* (1995) 32 Cal.App.4th 14, 22.) Downey does not go beyond the self-serving general declarations by Davis and him to point to admissible, affirmative evidence that Hartford waived its right to challenge the billing statement. His supporting evidence, which he does not refer to on appeal, suggested at best an expression of confidence by Nemec that Hartford's billing concerns would be resolved favorably to Downey.

Nor does Downey explain how he would have proceeded if he had known Hartford was going to question the invoices. Had he refused to settle, as he implies he would have, he would have incurred even more litigation costs, particularly if he had

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8 There is no evidence of any "affirmative claim" that was precluded by Hartford's settlement of the underlying action.

initiated a cross-action. On the other hand, he also declared that he would have instructed his attorney *not* to take such an "active, time consuming role in the case." How his attorney could have taken a less active role than settlement following the alleged representations remains unclear.[9] We must conclude, therefore, that there was no triable issue regarding the elements of either justifiable reliance or resulting damage.

Disposition

The judgment is affirmed.

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Elia, J.

WE CONCUR:

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Rushing, P. J.

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Mihara, J.

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9 Davis's own assertion that he would have "substituted out" likewise does not permit the inference that Downey's legal fees would have decreased.